

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of)  
HAWAIIAN ELECTRIC COMPANY, INC. )  
for Approval to Defer Certain )  
Computer Software Development )  
Costs for Item P0000828, Outage )  
Management System, to Accumulate )  
an Allowance for Funds Used During )  
Construction During the Deferral )  
Period, to Amortize the Deferred )  
Costs, and to Include the )  
Unamortized Deferred Costs in )  
Rate Base. )

DOCKET NO. 04-0131

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DIV. OF CONSUMER ADVOCACY  
DEPT. OF COMMERCE AND  
CONSUMER AFFAIRS  
STATE OF HAWAII

DECISION AND ORDER NO. 21899

Filed June 30, 2005  
At 3 o'clock P.M.

Karen Higashi  
Chief Clerk of the Commission

ATTEST: A True Copy  
KAREN HIGASHI  
Chief Clerk, Public Utilities  
Commission, State of Hawaii.

K. Higashi

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Decision and Order No. 21899

DECISION AND ORDER

By this Decision and Order, the commission approves the proposed accounting treatment requested by HAWAIIAN ELECTRIC COMPANY, INC. ("HECO") in relation to its Item P0000828, Outage Management System ("OMS") Project, described below.<sup>1</sup>

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<sup>1</sup>HECO's Application, Exhibits A-J, Verification and Certificate of Service, filed on May 28, 2004 ("Application"). HECO makes its requests for commission approval, as stated in its Application, pursuant to Decision and Order No. 18365, filed on February 8 2001, in Docket No. 99-0207 ("Decision and Order No. 18365").

I.

Background and Procedural History

As set forth in its May 28, 2004 Application, HECO seeks the commission's approval of various matters<sup>2</sup> related to the purchase and installation of a new, commercially available OMS, including: (1) purchase, configuration and testing of the software for the new system; (2) purchase and installation of related hardware, conversion and cleansing of data, i.e., assuring the converted data is accurate and in the correct format; and (3) development and testing of interfaces between the new system and other HECO systems.

On June 18, 2004 the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate") (collectively, with HECO, "Parties"), filed a preliminary statement of position in which it stated that it was unable to state its position on the merits of the Application because it had concerns over the reasonableness of: (1) HECO investing in the OMS; (2) estimated project costs; (3) the deferral of software development costs; (4) accumulating an AFUDC during the deferral period; and (5) the inclusion of the unamortized deferred costs in rate base.

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<sup>2</sup>In particular, HECO requests to defer certain computer software development costs for the OMS Project, to accumulate an allowance for funds used during construction ("AFUDC") during the deferral period, to amortize the deferred costs, and to include the unamortized deferred costs in rate base (hereinafter, referred to as "Proposed Accounting Treatment").

By Order No. 21123, filed on July 16, 2004, the commission ordered the Parties to stipulate to a procedural order in which the issues, procedures and schedule with respect to the instant docket are set forth. The Parties filed a proposed stipulated procedural order on August 13, 2004, which the commission filed, as Stipulated Procedural Order No. 21323, on August 27, 2004.

On August 30, 2004, the Consumer Advocate filed information requests ("IRs") for HECO. HECO filed responses to the IRs on September 20, 2004.

On October 12, 2004, the Consumer Advocate filed supplemental IRs for HECO, to which HECO filed responses on October 26, 2004.

On October 29, 2004, the commission filed Protective Order No. 21430 which set forth the procedures governing the treatment of documents deemed confidential by the Parties. Pursuant to Protective Order No. 21430, on November 1, 2004, HECO filed confidential responses to the Consumer Advocate's IRs.

By letter filed on November 16, 2004, the Consumer Advocate requested an extension of time, until December 17, 2004, in which to file its statement of position in the instant docket ("Statement of Position"). On December 6, 2004, the commission granted the Consumer Advocate's request for an extension of time.

The Consumer Advocate filed its Statement of Position on December 17, 2004.

By letter filed on January 18, 2005, HECO requested an extension of time, until January 20, 2005, in which to file a reply to the Consumer Advocate's Statement of Position ("Reply Statement of Position"). The commission granted HECO's request by letter filed on January 19, 2005. By proposed stipulated procedural order filed on January 20, 2005, HECO requested a further extension of time in which to file its Reply Statement of Position, to January 31, 2005.<sup>3</sup> The commission granted HECO's request in Stipulated Procedural Order No. 21568, filed on January 28, 2005.

HECO filed its Reply Statement of Position on January 31, 2005.

On April 21, 2005, as the result of discussions and negotiations between the Parties,<sup>4</sup> the Parties filed a joint letter of agreement ("Letter of Agreement") documenting the agreements reached between the Parties with regard to HECO's instant Application (the "Agreement"). The Parties state that the Letter of Agreement supercedes the recommendations and comments by the Consumer Advocate in its Statement of Position and by HECO in its Reply Statement of Position.

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<sup>3</sup>The Consumer Advocate did not object to both of HECO's requests for an extension of time.

<sup>4</sup>Beginning on March 17, 2005, the Parties met to discuss the Consumer Advocate's concerns with the OMS Project. Subsequent discussions and negotiations followed. See Letter of Agreement at 2.

As we stated in Decision and Order No. 21798, filed on May 3, 2005, in Docket No. 04-0268 ("Decision and Order No. 21798"), the commission intends to undertake an independent review and analysis of the OMS Project, notwithstanding the fact that the OMS Project is intended to be integrated with the Customer Information System ("CIS") Project discussed in Docket No. 04-0268. Similar to Decision and Order No. 21798, the commission will review the justness and reasonableness of the Agreement reached by and between the Parties, as reflected in their April 21, 2005 Letter of Agreement. However, as discussed in more detail below, the commission's primary focus in this Decision and Order will be on (1) the merits of the OMS Project and (2) whether HECO's Proposed Accounting Treatment of costs for the OMS Project is reasonable.

## II.

### Description of the OMS

The OMS Project involves the purchase and installation of a new, commercially available OMS. This includes: (1) purchase, configuration and testing of the software for the new system; (2) purchase and installation of related hardware; (3) conversion and "cleansing" of data (i.e., assuring the converted data is accurate and in the correct format); (4) development and testing of interfaces between the

new system and other HECO systems such as the CIS<sup>5</sup>, the Automated Mapping/Facilities Management mapping system, the Interactive Voice Response system, and the Energy Management system; and (5) associated training for HECO employees.

OMS is an information technology system that has capabilities that include: (1) collecting trouble information for the purpose of determining, through predictive analysis, the most likely cause of the outage; (2) providing status updates of an outage; (3) identifying work crews capable of addressing the outage; (4) scheduling and dispatching work orders to the field; (5) managing field personnel addressing the outage; and (6) providing historical outage data and reports.<sup>6</sup> HECO currently does not have an OMS. The OMS will replace many of the functions now performed manually by HECO and will provide the support system needed to automate these functions.

HECO represents that the OMS will allow HECO personnel more time to concentrate on restoring power to HECO customers in the event of a power outage, rather than managing the flow of

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<sup>5</sup>In Decision and Order No. 21798, the commission approved the application of HECO, Hawaii Electric Light Company, Inc. ("HELCO") and Maui Electric Company, Limited to expend, with certain conditions imposed by the commission, approximately \$20,350,000 for the CIS Project. CIS replaced another customer information system, the Automated Corporate Customer Energy Services System ("ACCESS"). ACCESS was designed in the 1980's and implemented in 1991. As such, ACCESS was viewed as outdated and functionally limited and thus replaced by CIS. Provided HECO receives commission approval in the instant docket, CIS is intended to integrate with the OMS and other components of HECO's telecommunications system, as noted above. See Decision and Order No. 21798 at 39-40.

<sup>6</sup>Application at 2.

papers or trouble tickets currently used for assessing and managing outages. OMS will assist in dispatching and managing the repair crews to locations where repairs are necessary and will also be able to produce historical outage data and reports in addition to providing a display of the status of an outage. Finally, the OMS will assist HECO personnel in disseminating up-to-date information regarding outages to customers as they call to inquire about the status of outage incidents.

### III.

#### Proposed Accounting Treatment of OMS

The total cost estimate to install the OMS is approximately \$5.8 million. HECO requests permission to defer the recognition of certain OMS project expenses by accumulating them over the period in which the OMS is being purchased and installed, rather than recognize expenses in the period in which they are incurred. HECO intends to recognize the deferred expenses when the OMS project is completed by amortizing the accumulated OMS expenses over a twelve-year period.<sup>7</sup> HECO states that its Proposed Accounting Treatment is consistent with Statement of Position 98-1 ("SOP 98-1"), *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, issued in March 1998 by the American Institute of Certified

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<sup>7</sup>HECO originally proposed a ten-year amortization period, however as part of their Agreement, the Parties have agreed to a twelve-year amortization period.



Public Accountants, Inc. ("AICPA") Financial Accounting Standards Board ("FASB")<sup>8</sup>.

HECO's Proposed Accounting Treatment of the OMS Project costs is set forth in Exhibit A of the Application, and consists of three (3) stages: (1) Stage 1, Preliminary; (2) Stage 2, Application Development; and (3) Stage 3, Post Implementation/Operation. Depending on the stage in which costs are incurred, the OMS project costs will be either expensed or capitalized (i.e., deferred). Thus, Stage 1 costs are expensed, Stage 2 costs are generally capitalized, however certain training costs, as well as certain conversion costs are charged to expense,<sup>9</sup> and Stage 3 costs are expensed.

As noted above, HECO states that AFUDC is applied to the deferred project costs during Stage 2 and that the deferred costs will be amortized over a twelve-year period, or other such amortization period that the commission finds reasonable, to the appropriate operating and maintenance expense account. The amortization period will commence the month after Stage 2 is completed.<sup>10</sup> HECO further states that the deferred costs are included in the calculation of rate base and that the accounting

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<sup>8</sup>The Consumer Advocate notes that SOP 98-1 was issued by the FASB and AICPA because of issues raised regarding costs incurred to develop software and the appropriate accounting treatment for those costs in Docket No. 99-0207, an application by Hawaii Electric Light Company, Inc. for commission approval to recover \$1,064,000 over a five-year period for deferred computer software development costs. Statement of Position at 26-27.

<sup>9</sup>For the specific proposed treatment of Stage 2 costs, see Exhibit A to the Application.

<sup>10</sup>Exhibit A to the Application at 2.

treatment for capital costs, (i.e., hardware costs), will follow existing practices.

#### IV.

##### The Consumer Advocate

Prior to the Parties' Agreement, the Consumer Advocate had concerns regarding both the OMS Project and the Proposed Accounting Treatment. In light of the Parties' Agreement, as evidenced by their Letter of Agreement filed with the commission on April 21, 2005, and as the Parties recognize that the recommendations contained in the Agreement "herein replace and supersede the recommendations and comments in the Consumer Advocate's Statement of Position . . . and the recommendations and comments in HECO's Reply Statement of Position",<sup>11</sup> the commission will briefly touch upon the Consumer Advocate's concerns.

In summary, the Consumer Advocate's concerns as stated in its Statement of Position are: (1) lack of justification by HECO of the OMS Project; (2) costs for the OMS Project are subject to verification; and (3) HECO's Proposed Accounting Treatment of the OMS Project costs. As noted above and in the Letter of Agreement, recommendations in the Agreement supersede comments and recommendations in the Consumer Advocate's Statement of Position and HECO's Reply Statement of Position.

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<sup>11</sup>Letter of Agreement at 1.

V.

The Agreement

The Parties agree to seven (7) conditions in response to the Consumer Advocate's overall concerns, noted above, and these conditions are set forth in their Letter of Agreement as follows:

1. Within twelve (12) months of the completion of the Proposed Project's bid process, HECO agrees to notify the commission and the Consumer Advocate of the quality of service measures that are produced automatically by the new OMS. After such notification, HECO agrees to meet with the Consumer Advocate to discuss the possibility of tracking and reporting relevant quality of service measurements (on a forward looking basis) that are automatically produced by the OMS. At the conclusion of such discussions, HECO will notify the commission and Consumer Advocate of the quality of service measures that HECO will track on a going forward basis after the Proposed Project is placed in service.

In addition, HECO agrees to continue to report on an annual basis the following quality of service measures:

- a. Customer Average Interruption Duration;
- b. System Average Interruption Frequency;
- c. System Average Interruption Duration; and
- d. Average Service Availability.

2. HECO will submit an interim supplemental report within thirty (30) days after the OMS Project's bid process is complete that contains the name of the contractor selected, the

scope, functional requirements and cost of the OMS Project.<sup>12</sup> This filing is not intended to result in any immediate regulatory action, and should only be considered a notification requirement.

3. HECO agrees to file notification letters with the commission and the Consumer Advocate if and when there is a significant change in either the functionality or cost of the OMS Project from the contract entered into with the vendor. The term "significant", as used in this section, is defined as an increase or decrease in projected cost of the OMS Project, as stated in the Application or most recent estimate of the OMS Project cost, of over five (5) per cent (5%). This filing is not intended to result in any immediate regulatory action, and should only be considered as a notification requirement.

4. The Parties agree that the accounting treatment of the OMS Project will be in conformance with Generally Accepted Accounting Principles ("GAAP"), including the Emerging Issues Task Force bulletin ("EITF") 97-13, *Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project that Combines Business Process Reengineering and Information Technology Transformation*, and SOP 98-1.

a. Accordingly, HECO agrees to work with the Consumer Advocate to identify costs related to reengineering, if any, after the contract award.<sup>13</sup>

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<sup>12</sup>This information will be made available to the commission and Consumer Advocate for review pursuant to Protective Order No. 21430.

<sup>13</sup>Reengineering costs incurred as a result of the new OMS will be expensed.

b. Certain overhead costs, relating to energy delivery and corporate administration, might be included in the deferred costs. The current Ellipse system includes such costs as part of the normal overhead calculation process. The Parties agree that to the extent that certain overhead costs that should be expensed in accordance with SOP 98-1 are included in the deferred costs, HECO will identify and track the overhead costs and reclassify the costs, as appropriate.

5. HECO will file within sixty (60) days of commercial operation of the OMS, a cost report that provides the appropriate work orders that state whether the OMS Project costs were capitalized, deferred or expensed, along with summary supporting documentation. In general, to the extent that costs are properly classified as capital/deferred costs, the Consumer Advocate does not object to the accrual of AFUDC on these costs.

6. HECO estimates that the expected useful life of the OMS Project is ten (10) years. However, HECO does not object to, and will amortize the OMS Project over a twelve (12) year period.

7. HECO acknowledges that the Consumer Advocate reserves the right to address the reasonableness of the amount of the OMS Project costs deferred and included in HECO's rate base pending a review of the final cost report submitted for the OMS Project. Further, the Parties understand that any issues with the amount of OMS Project costs to be included in rate base for ratemaking purposes will be addressed in a rate case

conducted with a test year in which or after which the component is completed and placed in service.

In conclusion, the Parties recommend to the commission, subject to the agreements outlined in items (1) through (7) above, that HECO be allowed to:

1. Defer (i.e., capitalize) certain computer software development costs for the OMS Project.
2. Accumulate AFUDC on the deferred costs during the deferral period.
3. Amortize the deferred costs over a twelve (12)-year period.
4. Include the unamortized costs in rate base.

## VI.

### Discussion

Similar to Decision and Order No. 21798, HECO states that this Application is filed in light of HELCO's 2000 test year rate case Decision and Order No. 18365 in Docket No. 99-0207, in which the commission disallowed from expenses and rate base the cost associated with APPRISE, a computer software development project because the costs for APPRISE were last incurred in 1999, outside of the 2000 test year.<sup>14</sup> For the same reasons articulated in Decision and Order No. 21798 relating to the CIS Project, the commission finds that the facts and circumstances in the instant docket involving the OMS Project differ from APPRISE in Docket No. 99-0207. As stated previously, and consistent with

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<sup>14</sup>See Decision and Order No. 21798 at 31-32.

Decision and Order No. 21798, in Docket No. 04-0268, the commission's review of the instant matter will focus on (1) the merits of the OMS Project and (2) whether HECO's Proposed Accounting Treatment of costs for the OMS Project is reasonable.

The commission notes that the instant proceeding is consistent with Decision and Order No. 21798 in that HECO also seeks permission to defer certain computer software development costs, accumulate AFUDC on the deferred costs during the deferral period, amortize the deferred costs, and include the unamortized costs in rate base. As in Decision and Order No. 21798, we also find that under these specific circumstances, it would have been appropriate for HECO to make a specific request for approval to commit funds for the OMS Project.

As put forth by the Consumer Advocate, the combined total of the hardware costs and the application development costs exceed \$2.5 million,<sup>15</sup> the threshold cost for capital improvement projects requiring commission approval. The Consumer Advocate assumed that HECO did not seek commission approval pursuant to G.O. No. 7 since the hardware costs, normally the only costs to be capitalized, are less than the \$2.5 million threshold.<sup>16</sup>

We agree with the Consumer Advocate that the need for the OMS Project must be determined before evaluating the

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<sup>15</sup>See Section 2.3(g)2 of General Order No. 7, *Standards for Electric Utility Service* ("G.O. No. 7"), as modified by Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257.

<sup>16</sup>Statement of Position at 3-4.

reasonableness of HECO's Proposed Accounting Treatment.<sup>17</sup> If this Application is approved by the commission, it would achieve virtually the same result as if the Application were filed pursuant to G.O. No. 7. Accordingly, the commission need not decide in this instance whether HECO must file an application for approval of a capital expenditure project under G.O. No. 7.

A.

Merits of the OMS Project

HECO states that, at present, responding to unplanned outages and identifying customers that will be affected by planned outages are manually intensive activities for HECO personnel. Unplanned power outages pose an even more critical situation due to the nature of unplanned events.

The OMS will be a useful tool for preparing for and managing outages. The OMS will take manually intensive functions and provide the support system that automates these functions. Outage management systems are designed specifically to assist dispatchers with managing outages. They are designed to organize and present trouble call information graphically on system maps so that all information is available to dispatchers in one location. Benefits of the OMS include quicker restoration of power to HECO customers, increased customer satisfaction, and the potential for HECO for reduced outage claims from its customers.

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<sup>17</sup>HECO's Application, and the Consumer Advocate's Statement of Position discussed the need and merits of the OMS Project.



The commission, thus, finds that the acquisition of the OMS by HECO is reasonable and in the public interest.

B.

Whether HECO's Proposed Accounting Treatment is Reasonable

The Parties have agreed that the Proposed Accounting Treatment for the OMS Project will be in accord with the GAAP, including the EITF 97-13.<sup>18</sup> The commission finds the Parties' Proposed Accounting Treatment for the OMS Project pursuant to terms of the Agreement, under the present facts and circumstances of the instant docket, to be reasonable and consistent with Decision and Order No. 21798. In particular, the commission finds the Parties' Agreement to allow HECO to accumulate an AFUDC on the deferred costs during the deferral period, to amortize the deferred costs over twelve (12) years, and to include the unamortized deferred costs in rate base, to be reasonable and in the public interest.

The Parties have taken steps to assure that any previous concerns of the Consumer Advocate have been alleviated. HECO has agreed to notify the commission and the Consumer Advocate, within twelve (12) months of completion of the OMS Project's bid process of the quality of service measures that are produced automatically by the OMS. Also, within thirty (30) days after the OMS bid process is complete, HECO will submit an interim report on, among other things, the cost of the

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<sup>18</sup>EITF 97-13 was also implemented in response to concerns regarding costs incurred to develop software, and the appropriate accounting treatment for those costs. See n.7, *supra*.

OMS Project. Finally, HECO agrees to file notification letters to the commission and the Consumer Advocate if and when there is a significant change in either the functionality, or cost of the OMS Project.

Based on the foregoing, the commission approves HECO's requests, as set forth in its Application and more specifically reflected and amended in the terms of the Parties' Agreement, to defer certain computer development costs of the OMS Project, accumulate an AFUDC on the deferred costs during the deferral period, amortize the deferred costs over twelve (12) years, and include the unamortized deferred costs in its rate base.

## VII.

### Orders

#### THE COMMISSION ORDERS:

1. HECO's request to expend approximately \$5.8 million for the OMS Project is approved; provided that no part of the OMS Project may be included in HECO's rate base unless and until the OMS is in fact installed, and is used and useful for public utility purposes.

2. HECO's request to defer certain computer software development costs for Item P0000828, Outage Management System, accumulate an AFUDC on the deferred costs during the deferral period, amortize the deferred costs over twelve (12) years, and include the unamortized deferred costs in rate base, are approved; subject to the commission's adoption of the

Parties' seven (7) conditions, set forth in Section V of this Decision and Order, and incorporated by reference herein.

3. Unless otherwise ordered, HECO shall file the following reports or information with the commission, with copies served upon the Consumer Advocate:

A. Within twelve (12) months following completion of the OMS Project's bid process, information on the performance and quality of service measures that are produced automatically by the OMS. In addition, HECO will continue to report on an annual basis on the following quality of service measures:

- a. Customer Average Interruption Duration;
- b. System Average Interruption Frequency;
- c. System Average Interruption Duration; and
- d. Average Service Availability.

B. An interim supplemental report within thirty (30) days after the OMS bid process is complete containing the name of the contractor selected, the scope, functional requirements and cost of the OMS Project.

C. Prompt notification letters to the commission and the Consumer Advocate if and when there is a significant change in either the functionality or cost of the OMS Project.

D. Within sixty (60) days of the commercial operation of OMS, a cost report that provides the appropriate work orders that state whether the OMS costs were capitalized, deferred, or expensed, along with summary supporting documentation.

4. HECO shall conform to the commission's orders set forth above. Any failure to adhere to the commission's orders

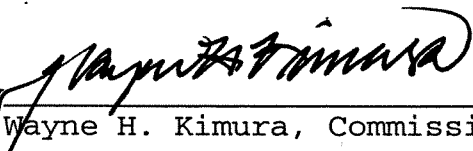
shall constitute cause for the commission to void this Decision and Order, and may result in further regulatory action as authorized by law.

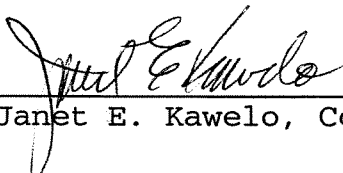
5. This docket is closed unless otherwise ordered by the commission.

DONE at Honolulu, Hawaii JUN 30 2005.


PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By   
Wayne H. Kimura, Commissioner

By   
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

  
Benedyne S. Stone  
Commission Counsel

04-0131.rpr

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21899 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: JUN 30 2005